RECENT DEVELOPMENTS IN THE IBC REGIME

January 18, 2018

AMENDMENTS TO THE INSOLVENCY AND BANKRUPTCY CODE

Introduction

It has been just over a year that the provisions relating to corporate insolvency resolution in the Insolvency and Bankruptcy Code, 2016 ("**IBC**") were brought into force. Since then more than 400 (four hundred) petitions for corporate insolvency resolution have been admitted by the National Company Law Tribunal ("**NCLT**"). Out of these, in several cases, a resolution plan for the insolvency resolution of the corporate debtors has been approved by NCLT.

In some cases, the promoters of the corporate debtor were the successful resolution applicants of their own company and thereby the promoters regained control of their company. This 're-entry' by the promoters was frowned upon by the Government of India ("**GOI**") as it was perceived to be unfair and defeating the purpose of the IBC. Accordingly, the GOI promulgated an Ordinance[1] to amend the IBC. As per the press release of the GOI, *"the Ordinance aims at putting in place safeguards to prevent unscrupulous, undesirable persons from misusing or vitiating the provisions of the Code"*. The press release goes on to state that *"the amendments aim to keep-out such persons who have wilfully defaulted, are associated with non-performing assets, or are habitually non-compliant and, therefore, are likely to be a risk to successful resolution of insolvency of a company"*.

The Ordinance is sought to be replaced by the Insolvency and Bankruptcy Code (Amendment) Bill, 2017 ("**IBC Amendment**"). The IBC Amendment was recently passed by Lok Sabha and Rajya Sabha.

The key changes introduced by the IBC Amendment are discussed below.

Eligibility criteria for resolution applicants

The IBC, as originally enacted, allowed any person to be a resolution applicant i.e. any person could submit a resolution plan for a corporate debtor against whom a corporate insolvency resolution process has been initiated. Under section 25(2)(h) of the IBC, a resolution professional ("**RP**") was required to invite prospective lenders, investors, and any other persons to put forward resolution plans. These provisions are sought to be amended by the IBC Amendment.

The IBC Amendment requires an RP to invite only those applicants to submit a resolution plan who fulfil the criteria as laid down by him with the approval of the committee of creditors, having regard to the complexity and scale of operations of the business of the corporate debtor and such other conditions which may be specified by the Insolvency and Bankruptcy Board ("**IBBI**").

[1] Under Article 123 of the Constitution of India, the President of India has the power to promulgate ordinances when neither the Lok Sabha nor the Rajya Sabha are in session if there are circumstances which render it necessary to take immediate action. Every such Ordinance is required to be laid before both Houses of Parliament and shall cease to operate at the expiration of 6 (six) weeks from the reassembly of Parliament.

Further, a new section 29A has been introduced in the IBC which sets out certain disqualification parameters. Notably, a person is disqualified to submit a resolution plan if the person or any other person acting jointly or in concert with such person, has an account which is classified as a non-performing asset ("**NPA**") or if such person is a promoter or in management or control of a corporate debtor whose account has been classified as an NPA and 1 (one) year has lapsed from the date of classification till the date of commencement of the corporate insolvency resolution process of the corporate debtor. Thus, existing promoters would find it very difficult to bid for their own companies. However, such persons can submit a resolution plan if they make payment within such period decided by committee of creditors (not exceeding 30 (thirty) days) of all overdue amounts with interest thereon and charges relating to NPA accounts before submission of resolution plan.

A person shall also not be eligible as a resolution applicant, if such person, or any other person acting jointly or in concert:

- is an undischarged insolvent;
- is a wilful defaulter in accordance with the guidelines of Reserve Bank of India under the Banking Regulation Act, 1949;
- has been convicted for any offence punishable with imprisonment for 2 (two) years or more;
- is disqualified to act as a director under the Companies Act, 2013;
- is prohibited by Securities and Exchange Board of India ("**SEBI**") from trading in securities or accessing the securities markets;
- has been a promoter or in the management or control of a corporate debtor in which a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place and in respect of which an order has been made by NCLT under the IBC;
- has executed an enforceable guarantee in favour of a creditor in respect of a corporate debtor against which an application for insolvency resolution made by such creditor has been admitted;
- has been subject to any disability, corresponding to the above, under any law in a jurisdiction outside India.

Connected persons

Pursuant to the IBC Amendment, even if a 'connected person' of a person is ineligible to be a resolution applicant pursuant to section 29A of IBC, then the person cannot submit a resolution plan. The expression 'connected person' has been given a wide meaning. Following would qualify as connected persons:

- any person who is the promoter or in the management or control of the resolution applicant; or
- any person who shall be the promoter or in management or control of the business of the corporate debtor during the implementation of the resolution plan; or
- the holding company, subsidiary company, associate company or related party of a person referred to in clauses (a) and (b) above[2].

Approval of resolution plan by Committee of Creditors

Under the IBC, the committee of creditors may approve a resolution plan by a vote of not less than 75% (seventy five per cent) of voting share of the financial creditors. The IBC Amendment requires the committee to consider the feasibility and viability of a resolution plan before approving the same.

Restriction on selling of property to ineligible resolution applicants

The IBC Amendment prohibits a liquidator (who is appointed once the NCLT passes an order for liquidation of a company) from selling movable or immovable property or actionable claims of a corporate debtor in liquidation to any person who is not eligible to be a resolution applicant.

Penalties for unspecified offences under IBC

The IBC Amendment seeks to insert a new section 235A for imposing a fine for contravention of the IBC or the rules and regulations made thereunder, and for which no penalty or punishment is provided. For such contraventions, a fine not less than Rs. 1,00,000 (Rupees one lac) and extending to Rs. 2,00,00,000 (Rupees two crore) may be imposed.

[2] Scheduled banks, asset reconstruction companies and alternate investment funds registered with SEBI are exempt from this requirement.

AMENDMENTS TO THE CIRP REGULATIONS

Introduction

The IBBI recently notified the IBBI (Insolvency Resolution Process for Corporate Persons) (Fourth Amendment) Regulations, 2017 which are in effect from December 31, 2017 ("**CIRP Amendment**") amending the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 ("**CIRP Regulations**").

The key amendments introduced are discussed below.

Liquidation Value

Prior to the CIRP Amendment, an RP was required to provide the liquidation value to the committee of creditors. The liquidation value was also required to be stated in the information memorandum circulated to the prospective resolution applicant.

Pursuant to the CIRP Amendment, the information memorandum is not required to state the liquidation value. After the receipt of resolution plans, the RP is required to provide the liquidation value to every member of the committee of creditors after obtaining an undertaking from the member to the effect that such member shall maintain confidentiality of the liquidation value and shall not use such value to cause an undue gain or undue loss to itself or any other person. The RP is also required to maintain confidentiality of the liquidation value.

Dissenting financial creditors

Under regulation 38(1)(c) of the CIRP Regulations, a resolution plan is required to identify specific sources of funds that will be used to pay the liquidation value due to dissenting financial creditors and provide that such payment is made before any recoveries are made by the financial creditors who voted in favour of the resolution plan. 'Dissenting creditors' were defined as financial creditors who voted against the resolution plan approved by the committee of creditors. Pursuant to the CIRP Amendment, 'dissenting creditors' now include a financial creditor who voted against the resolution plan *as well as a financial creditor who abstained from voting* for the resolution plan, approved by the committee.

Time bound submission of resolution plan

The CIRP Regulations stated that a resolution applicant should endeavour to submit a resolution plan to the resolution professional, 30 (thirty) days before expiry of the maximum period permitted under section 12 of the IBC for the completion of the corporate insolvency resolution process. Pursuant to the CIRP Amendment, a resolution applicant is now required to submit a resolution plan within the time given in the invitation by the RP for submitting resolution plans.

LIABILITY OF RESOLUTION PROFESSIONALS

IBBI has issued a circular bearing no. IP/002/2018 dated January 3, 2018. Pursuant to the said circular, IBBI has directed that while acting as an interim resolution professional, a resolution professional or liquidator for corporate person under IBC, an insolvency professional should exercise reasonable care and diligence and take all necessary steps to ensure that the corporate person undergoing any process under the IBC complies with applicable laws.

The circular also states that if a corporate person during any of the aforesaid processes under the IBC suffers any loss, including penalty (if any) on account of non-compliance of any provision of the applicable laws, such loss shall not form part of insolvency resolution process cost or liquidation process cost under the IBC. The insolvency professional would be responsible for non-compliance of provisions of applicable laws if it is on account of his conduct.

AMENDMENTS TO THE COMPANIES ACT, 2013

Introduction

The Central Government recently notified the Companies (Amendment) Act, 2017 ("**Amendment Act**") amending certain provisions of the Companies Act, 2013 ("**Companies Act**").

Some of the changes have a bearing on the working of the IBC and are discussed below.

Issuance of shares at a discount

Section 53 of the Companies Act prohibited issuance of shares at a discount. The Amendment Act now allows companies to issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking Regulation Act, 1949.

Managerial remuneration

Under section 197 of the Companies Act, approval of the company in a general meeting was required for the payment of managerial remuneration in excess of 11% (eleven percent) of the net profits. The Amendment Act now requires that where a company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, for such payment of managerial remuneration should be obtained by the company before obtaining the approval in the general meeting.

Valuers

Section 247 of the Companies Act prohibited a registered valuer from undertaking valuation of any assets in which he has a direct or indirect interest or becomes so interested at any time during or after the valuation of assets. The Amendment Act now prohibits a registered valuer from undertaking valuation of any asset in which he has direct or indirect interest or becomes so interested at any time *during 3 (three) years prior to his appointment as valuer or 3 (three) years after valuation of assets was conducted by him*.

RELAXATIONS IN THE PROVISIONS RELATING TO LEVY OF MINIMUM ALTERNATE TAX (MAT)

Under section 115JB of Income-tax Act, 1961 ("**IT Act**"), in case of a company, if the income tax payable is less than a specified percentage of the book profits of the company, then such book profit is deemed to be the total income of the company. The amount of loss brought forward or unabsorbed depreciation, whichever is less as per books of accounts is reduced from the calculation of book profit.

Companies against whom corporate insolvency resolution process had been initiated were facing hardships due to allowance of brought forward loss for computation of book profit under section 115JB of IT Act.

In order to address the concerns raised, the Central Board of Direct Taxes issued a press release on January 6, 2018 stating that with effect from assessment year 2018-19 (i.e. financial year 2017-18), in case of a company against whom an application for corporate insolvency resolution process has been admitted, the amount of total loss brought forward (including unabsorbed depreciation) shall be allowed to be reduced from the book profit for the purposes of MAT under section 115JB of the IT Act. Appropriate legislative amendment in this regard will be made in due course.

RECENT DECISIONS ON GUARANTEES

Moratorium for guarantors

In *Sicom Investments and Finance Limited* v. *Rajesh Kumar Drolia*[3], one of the issues which came up for consideration before the Bombay High Court was whether by virtue of the fact that an order of moratorium had been passed under section 14 of the IBC in respect of the principal borrower, the suit against the guarantors could not be proceeded with.

For ease of reference, the relevant extract of section 14 of the IBC is reproduced hereinbelow:

> *"Subject to provisions of sub-sections (2) and (3), on the insolvency commencement date, the Adjudicating Authority shall by order declare moratorium for prohibiting all of the following, namely –*
> *(a) the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority;*
> *(b) transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein;*
> *[…]"* (emphasis supplied)

The Bombay High Court observed that from a plain reading of section 14 it is clear that the moratorium under the section applies only to the 'corporate debtor'. It was held that the prohibition on institution/ continuation of suits is applicable only to the corporate debtor which is in insolvency and not any third party such as a guarantor, be it an individual or a corporate guarantor.

In this case, the Bombay High Court also considered the decision of the Allahabad High Court in *Sanjeev Shriya* v. *State Bank of India*[4], where the Allahabad High Court held that once an order of moratorium is passed under section 14 of the IBC, the proceedings against the guarantors have to be stayed. The Allahabad High Court was of the view that proceedings against the guarantors cannot be continued unless the liability of the principal debtor as well as that of the guarantors is determined and crystalised.

The Bombay High Court disagreed with the view taken by the Allahabad High Court in the *Sanjeev Shriya* case and observed that the aforesaid decision does not give any reasoning as to how the order passed under section 14 in favour of the corporate debtor would automatically be beneficial to the guarantor without any insolvency resolution process being initiated by or against the guarantor.

In this regard, it may be noted that conflicting views have been taken on this issue by various benches of the NCLT. In *Schweitzer Systemtek* v. *Phoenix ARC Limited*[5] and *Alpha & Omega Diagnostics (India) Limited* v. *Asset Reconstruction of India & Ors.*[6], the Mumbai bench of NCLT held that the personal properties of the promoters of the corporate debtor, which have been provided as security to the lenders, will not be subject to the moratorium. On appeal to the NCLAT[7], it dismissed the appeal as it took the view that the order of the NCLT was in accordance with law.

[3] *Sicom Investments and Finance Limited* v. *Rajesh Kumar Drolia and Ors.,* Summons for Judgment No. 221 of 2010 in Commercial Suit No. 44 of 2010, order dated November 28, 2017 by the Bombay High Court.

[4] *Sanjeev Shriya* v. *State Bank of India,* Writ C. No. 30285 of 2017, order dated September 6, 2017 by the Allahabad High Court.

[5] *Schweitzer Systemtek* v. *Phoenix ARC Limited,* T.C.P. No. 1059/I&BP/NCLT/MB/MAH/2017, order dated July 3, 2017 by NCLT, Mumbai.

[6] *Alpha & Omega Diagnostics (India) Limited v. Asset Reconstruction of India & Ors.,* T.C.P. No. 1117/I&BP/NCLT/MB/MAH/2017, order dated July 10, 2017 by NCLT, Mumbai.

[7] *Schweitzer Systemtek* v. *Phoenix ARC Limited,* Company Appeal (AT) (Insolvency) No. 129 of 2017, order dated August 8, 2017 by the NCLAT. *Alpha & Omega Diagnostics (India) Limited* v. *Asset Reconstruction Company of India Limited & Ors.,* Company Appeal (AT) (Insol) No. 116 of 2017, order dated July 31, 2017 by the NCLAT.

However, in *V. Ramakrishnan* v. *Veesons Energy Systems Private Limited*[8], the Chennai bench of NCLT held that a financial creditor cannot proceed against the personal guarantor of the corporate debtor during the moratorium period. The NCLT observed that, if the financial creditor is permitted to proceed against the personal guarantor of the corporate debtor during the moratorium period for recovery of the outstanding debt to the extent of the personal guarantee given, the security interest (if any) of the financial creditor shall get transferred to the guarantor which will be in violation of section 14(1)(b) of the IBC.

Admission of claims in respect of guarantees

In *Axis Bank Limited v. Edu Smart Services Private Limited*[9], the Principal Bench of NCLT dealt with the issue whether a creditor is entitled to make a claim by invoking a corporate guarantee given by a corporate debtor after the commencement of the insolvency resolution process under the IBC against such corporate debtor.

In this regard, the NCLT referred to the provisions of regulation 13(1) of the CIRP Regulations which provides that the RP is required to verify every *claim as on the insolvency commencement date*, i.e. the date of admission of the insolvency application by the NCLT.

The NCLT also referred to the definitions of 'claim' and 'debt' under the IBC which are as follows:

> "*"claim" means--*
> *(a) a right to payment, whether or not such right is reduced to judgment, fixed, disputed, undisputed, legal, equitable, secured or unsecured;*
> *(b) right to remedy for breach of contract under any law for the time being in force, if such breach gives rise to a right to payment, whether or not such right is reduced to judgment, fixed, matured, unmatured, disputed, undisputed, secured or unsecured*"

> "*"debt" means a liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt;*" (emphasis supplied)

On a consideration of the aforesaid definitions, NCLT observed that in the instant case a 'debt' had not become due to the applicant on the insolvency commencement date since the corporate guarantee was invoked by the applicant after the insolvency commencement date.

Reference was also made to section 14(1)(c) of the IBC, which provides as follows:

> "*(c) any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002);*"

The NCLT held that invocation of corporate guarantee against the corporate debtor would result in enforcing of security interest and would thus be in violation of the provisions of section 14(1)(c) of the IBC.

The decision in the *Axis* Bank case was relied in *Bank of Baroda* v. *Binani Cements Limited*[10] as well as *Export-Import Bank of India* v. *JEKPL Private Limited*[11].

[8] *V. Ramakrishnan* v. *Veesons Energy Systems Private Limited,* IA 05/2017 in CP/510/(IB)/CB/2017, order dated September 18, 2017 by NCLT Chennai.
[9] *Axis Bank Limited* v. *Edu Smart Services Private Limited*, CP (IB)-102(PB)/2017, order dated October 27, 2017 by NCLT Principal Bench.
[10] *Bank of Baroda* v. *Binani Cements Limited*, CP (IB) No. 359/KB/2017, order dated November 17, 2017 by NCLT Kolkata.
[11] *Export-Import Bank of India* v. *JEKPL Private Limited,* CA No. 159/2017, order dated November 27, 2017 by NCLT Allahabad.

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